

**OFFICE OF THE SECRETARY OF STATE
CORPORATIONS DIVISION
PERFORMANCE AUDIT
MAY 2004**

**DEPARTMENT OF ADMINISTRATION
BUREAU OF AUDITS
ONE CAPITOL HILL
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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

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SECRETARY OF STATE
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EXECUTIVE SUMMARY

The Office of the Secretary of State changed administrations on January 7, 2003. It should be noted that the first 6 months of activity audited represents the practices and procedures of the former Secretary of State's administration. The subsequent 6-month period represents the transitional period for the new administration to review Department operations and begin to formulate practices and procedures accordingly.

A summary of findings include:

- Lack of compliance with the small purchasing regulations pursuant to RIGL 37-2-22.
- Unexplained petty cash shortage of \$26.
- The Division has not consistently deposited funds collected from the filing of annual reports within seven business days of receipt as prescribed in RIGL 11-28-1.
- The Division needs to ensure the proper segregation of duties for the deposit, recording, and verification of cash receipts.
- The Division and the Tax Administrator should seek to have the law pertaining to collection and assessment of late filing penalties on corporate returns changed to allow the Corporations Division to assess and collect the penalty.

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PERFORMANCE AUDIT

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May 18, 2004

Honorable Matthew A. Brown
Rhode Island Secretary of State
State House, Room 217
Providence, RI 02903

Dear Mr. Brown:

We have completed our audit of the Office of the Secretary of State, Corporations Division for the fiscal year ended June 30, 2003. Our audit was conducted in accordance with Sections 35-7-3 and 35-7-4 of the Rhode Island General Laws.

The findings and recommendations included herein have been discussed with management and we have considered their comments in the preparation of our report. Management's responses are included in this report.

In accordance with Section 35-7-4 (c) of the Rhode Island General Laws, we will review the status of the Secretary of State's Corporations Division corrective action plan within six months from the date of issue of this report.

Sincerely,

Frank J. Collaro, Jr., CFE, CGFM
Acting Chief, Bureau of Audits

FJC:pp

OFFICE OF THE SECRETARY OF STATE
CORPORATIONS DIVISION
PERFORMANCE AUDIT

INTRODUCTION

Objectives, Scope, and Methodology

We have conducted a performance audit of the Office of the Secretary of State Corporations Division [the Division] for the fiscal year ended June 30, 2003. Our objectives were to determine if the Division complied with laws and regulations and was acquiring, protecting, and using resources economically and efficiently.

Our audit was performed in accordance with the *Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors and included such tests of the accounting records and such auditing procedures as we considered necessary in the circumstances.

We evaluated the internal control structure of the programs and reviewed the policies and procedures developed by the Division. The formulation of the findings and recommendations contained in this report were based on our review and analysis of state laws and regulations; and interviews with personnel and tests of the effectiveness of policies and procedures followed to ensure compliance with applicable laws, regulations, and procedures.

The findings and recommendations included herein have been discussed with management, and we have considered their comments in the preparation of our report. Section 35-7-4 (c) of the Rhode Island General Laws requires the auditee to respond within 60 days to all recommendations in this report. Management's response to our audit findings and recommendations is included in our report.

Background

The Office of the Secretary of State is one of the five general offices established by the Rhode Island Constitution. The Secretary of State as a general officer is elected by the public. The Secretary of State Corporations Division is charged with the responsibility of administering various public documents under Rhode Island General Laws. Some of the functions performed by the Division include maintaining records of incorporated for-profit and non-profit domestic and foreign corporations, administration of the Uniform Commercial Code (UCC), registration of notary publics, and the registration of trademarks.

The Rhode Island General Laws applicable to the Division are:

Title 6, Chapter 2 – Registrations and Protection of Trademarks;

Title 6A – Uniform Commercial Code Acts;

Title 7 – Corporations, Associations, and Partnerships;

Title 11, Chapter 50 – Games of Chance;

Title 42, Chapter 30 – Notaries Public; and

Title 42, Chapter 132 – Business Fast-Start Office.

OFFICE OF THE SECRETARY OF STATE
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FINDINGS AND RECOMMENDATIONS

Delegated Small Purchase Authority

The Chief Purchasing Officer of the State of Rhode Island has the authority to promulgate small purchase regulations pursuant to RIGL 37-2-22. Small dollar purchases are defined as procurements that do not exceed the aggregate amount of ten thousand dollars (\$10,000) for construction projects and five thousand (\$5,000) for all other purchases.

The procedures for obtaining quotes are defined in the delegated small purchase authority procedures and are as follows:

Telephone Quotes: For procurements between \$251 and \$1,000 at least three telephone quotes, documented in writing by an agency official must be obtained.

Written Quotes: May be obtained through normal mail, personal delivery, or fax. For procurements above \$1,000 written confirmation of all offers must be obtained from vendors.

An official record of all quotes received must be maintained with a copy of the appropriate accounting document.

A review of expenditure records maintained by the Division indicated that small purchasing procedures were not followed. Records did not contain the proper documentation to substantiate the requirements of delegated small purchasing authority. Subsequent conversations with management confirmed that small dollar purchasing requirements were not properly followed and implemented in the past. However, management was aware of the lack of compliance and has taken the necessary steps to bring the Division into compliance with small dollar purchasing requirements.

Recommendation

1. Management needs to ensure that small dollar purchase requirements are followed.

Management's Response: Accepted

Imprest Cash Fund

The Division maintains an imprest cash fund that is divided and utilized by three sections within the division – the corporations section maintains a fund balance of \$100, the Uniform Commercial Code (UCC) section maintains a fund balance of \$50, and the bookkeeper maintains a balance of \$100. The corporation section and the UCC petty cash balances are primarily utilized as a change fund when conducting over-the-counter transactions involving cash. The balance maintained by the bookkeeper is primarily utilized for small operational expenditures.

We reviewed the records of the imprest cash fund count performed by the Office of the Secretary of State's personnel on May 30, 2003. The most recent count of cash maintained by the UCC section occurred on a Friday morning. This count revealed that the \$50 petty cash balanced maintained by the UCC section was short by \$14.75. A cash count conducted by the Bureau of Audits Staff on the following Monday, the next business day, revealed that the shortage had increased by \$11.25 to a total of \$26. A cash count was conducted the next day to verify the amount of the shortage. The additional shortage cannot be explained or justified by the Division's staff.

Recommendations

2. Restore the UCC cash fund to the \$50 balance.

Management's Response: Partially Accepted

3. Physical security of cash should be increased by the utilization of locking cash draws. Cash funds utilized by management for change making purposes should be reconciled on a daily basis.

Management's Response: Accepted

Electrical Usage Billings

The State, through the State Properties Committee, has entered into a lease agreement for several state agencies as tenants for properties located at 100 and 108 North Main Street. Under the provisions of the lease agreement the tenants are responsible for the payment of electricity usage. Narragansett Electric accounts for 100 and 108 North Main Street are maintained under the name of MSI Holdings, Inc. The Division's payments for electricity usage are made to MSI for the reimbursement of electrical usage associated with the leased property.

A review of payments made by the Division to MSI for electricity usage revealed an error in the billing for the period June 5-July 12, 2002 for 108 North Main Street. Narragansett Electric's calculations were based upon an inaccurate meter reading and resulted in an erroneous charge of \$1,771.40 that the Division reimbursed MSI. The amount charged should have been \$105.19, resulting in an overpayment of \$1,666.21 by the Division to MSI. To offset this overpayment the Division did not pay the \$1,237.54 electrical charges billed for the period July 12-August 12, 2002. The Division has paid all subsequent electrical bills in full as charged; therefore a \$428.67 overpayment with MSI remains outstanding.

In addition, the Division has not made payments to MSI for electrical usage since the bill covering the period of October 9, 2002 to November 9, 2002 was paid in December of 2002. The Division has not paid MSI for electrical usage because MSI has failed to supply the proper supporting documentation to substantiate the billings received. The Division is responsible for the payment of the outstanding electrical bills and should work with MSI to resolve this issue. The Division needs to ensure all future bills are reviewed and that only current activity is paid. The credit balance due from MSI needs to be applied to future electrical usage charges.

Recommendations

4. The Division in conjunction with the State Properties Committee should actively work with MSI to resolve the outstanding balance of electrical charges.
5. Apply the credit of \$428.67 owed from MSI to future electrical bills.

Management's Response: Accepted

Copy Fees

Our review of the fee schedule utilized by the Division indicated that they are charging fifteen cent (\$.15) per page for copying and providing documents to the public. Management has based this charge on Section 38-2-4 of the R.I. General Laws.

According to the following Sections of the R.I. General Laws the Secretary of State shall charge and collect a fee of fifty cents (\$.50) per page for copying a document:

- § 7-1.1-122 (1) – for-profit foreign and domestic corporations;
- § 7-6-93 (1) – non-profit corporations;
- § 7-16-65 (6) – limited liability companies; and
- § 42-8-20 (3) – copy for any document on file.

We can appreciate the efforts of the Division's staff to control the cost of governmental services provided to the citizen's of Rhode Island. However, those specific sections within Title 7 and Title 42 of the General Laws contradict the current practice.

Recommendation

6. The Secretary of State should charge the statutory amount of 50 cents or consider having legislation introduced to the current session of the general assembly to amend the copying fees charged for public documents to the current practice.

Management's Response: Rejected

Records Control Schedule

RIGL 38-3-2 (3) defines a records control schedule as “the document establishing the official retention, maintenance, and disposal requirements for a series or type of record based on administrative, legal, fiscal, and historical values for the scheduled records.” The program as defined in RIGL 38-3-2(4) “shall mean the public records administration program of the secretary of state.”

RIGL 38-3-6 (a) states in part that each agency shall prepare and submit a record control schedule for all public records in the custody of the agency. The Corporations Division of the Secretary of State has prepared but not yet submitted a record retention schedule as required under RIGL.

Recommendation

7. Comply with RIGL 38-3-6.

Management's Response: Accepted

Deposit of Funds Collected Within 7 Business Days

The Division receives annual corporate reports at different times during the year based upon the type of business entity filing the report. There are three classifications of entities that are required to file an annual report with the Division: domestic and foreign for-profit corporations, limited liability company's (LLC), and non-profit corporations. The returns are filed based on the following schedule:

- Foreign and domestic for-profit corporations are due January 1 to March 1;
- Non-profit corporations are due June 1 to June 30; and
- Limited liability company (LLC) is due September 1 to November 1.

It was observed that funds received for the annual reports filed for non-profit corporations were not deposited in a timely manner. RIGL 11-28-1 requires that all funds collected should be deposited in the bank within seven business days of receipt. Unprocessed annual reports and checks were observed that were 12 business days old.

The delay in the deposit of funds varies depending on the type of return filed and the time of year. The volume of returns filed during the peak filing periods is in excess of the resources allocated to process the reports and receipts in a timely manner as prescribed under statute. The delay in processing and depositing of cash receipts is a common occurrence and occurs with all types of returns to varying degrees.

Recommendation

8. Consider utilizing a lock box to ensure that cash received is deposited in a timely manner in accordance with RIGL 11-28-1.

Management's Response: Partially Accepted

Late Filing Penalties for Corporate Annual Reports

RIGL 7-1.1-128 calls for the assessment of a penalty for the late filing of an annual report. The statute states, "Each corporation, domestic or foreign, that fails or refuses to file its annual report for any year within the time prescribed by this chapter is subject to a penalty of ten percent (10%) of the amount of the franchise tax assessed against it for the period beginning July 1 of the year in which the report should have been filed. The penalty shall be assessed by the tax administrator at the time of the assessment of the franchise tax."

The Corporations Division and the Department of Administration, Division of Taxation do not utilize the same computer system or database. The lack of ability to freely exchange information has prevented the implementation of penalties as prescribed by statute. The Division of Taxation cannot identify if a corporation has filed a late annual report when assessing the franchise tax and therefore does not assess or collect the late filing fee for annual reports.

It appears that the Secretary of State should have the responsibility of assessing and collecting the penalty for late filings. The Corporations Division is already responsible for the filing and maintenance of corporate annual reports. Late filings can be easily identified and a penalty could be assessed by the division at the time of filing if the Division were authorized to assess the penalty under R.I. General Law. Management, however, would be limited by the exchange of data between the Corporations Division and the Division of Taxation and would not be capable of assessing a tax based upon the franchise tax filing. If the penalty were based upon a flat rate, the Corporations Division could effectively assess a penalty without interacting with the Division of Taxation.

Recommendation

9. The Secretary of State should consider having legislation introduced into the General Assembly to move the authority of assessing a 10 percent penalty of the franchise tax to a flat rate penalty to be assessed and collected by the Office of the Secretary of State.

Management's Response: Accepted

Segregation of Duties/Reconciliation

The Division implemented a new point of sales (POS) cash management system on July 1, 2003. The POS system records cash receipts in the accounting system maintained by the Division. The duties and responsibilities of employees utilizing the new system should be evaluated to ensure that functions involving the collection, depositing, and recording of cash receipts are properly segregated.

Policies and procedures need to be developed and implemented to ensure that cash received is properly recorded. Division staff should reconcile recorded receipts to deposits in the bank statement and the state accounting system. The Division should generate receipt adjustments for Non Sufficient Funds (NSF) check activity. Individual NSF checks should be traced and reconciled to the bank statement and state accounting system.

Recommendation

10. Review assigned duties to ensure that work functions are properly segregated. Develop and implement policies and procedures to reconcile receipts and Non Sufficient Funds check activity.

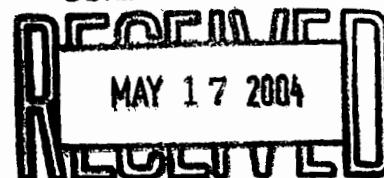
Management's Response: Accepted



STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
Office of the Secretary of State

Matthew A. Brown
Secretary of State

BUREAU OF AUDITS



May 14, 2004

Frank J. Collaro, Jr., CFE, CGFM
Acting Chief, Bureau of Audits
Department of Administration
One Capitol Hill
Providence, RI 02908-5889

**RE: Office of the Secretary of State, Corporations Division
Performance Audit Fiscal Year ended June 30, 2003**

Dear Mr. Collaro:

I have received your draft report for the above referenced audit. I am responding at this time in order to have my agency's comments on the findings and recommendations included in the final report. I would also like to take this opportunity to commend you and your staff on the professionalism and thoroughness demonstrated throughout this process.

Following are responses to each of the specific Recommendations made:

RECOMMENDATION #1: *Management needs to ensure that small dollar purchase requirements are followed.*

RESPONSE: Accepted.

As you know, my administration is responsible for the second half of the audit year being reviewed in this report and can only respond for that time period. One of my first administrative requests was that all of our purchases comply with State Purchasing Rules and state law. Additionally, in May 2003, I invited Helen Christy, Assistant Director for Special Projects of the State Purchasing Office to make a presentation to and answer questions from all management and fiscal personnel. Since the beginning of my administration, purchasing laws and procedures are being complied with for all applicable transactions.

RECOMMENDATION #2: *Restore the UCC cash fund to the \$50.00 balance.*

RESPONSE: Partially Accepted.

The UCC petty cash fund is used to make change for customers paying personally at the counter for UCC searches. During the audit year in question it had been maintained at \$50. If we had kept the balance of the UCC petty cash fund at \$50, we would agree to restore the balance to the \$50 amount. However, my fiscal staff has re-evaluated the petty cash fund balance requirements and determined that it can be adequately maintained at \$35.

Office of the
Secretary of State

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RECOMMENDATION #3: *Physical security of cash should be increased by the utilization of locking cash drawers. Cash funds utilized by management for change making purposes should be reconciled daily.*

RESPONSE: Accepted.

As part of the installation and implementation on July 1, 2003 of an electronic point of sale (POS) cash handling system, locking drawers were provided to all cashiers. Furthermore, I have required that staff reconcile change funds on a daily basis.

RECOMMENDATIONS #4, 5: *The Division in conjunction with the State Properties Committee should actively work with MSI to resolve the outstanding balance of electrical charges. Apply the credit of \$428.67 owed from MSI to future electrical bills.*

RESPONSE: Accepted.

My fiscal staff is reviewing and researching all electrical charges and payments made since the lease takeover by the new landlord (July 2002) at 100 North Main Street. This investigation is ongoing but will be resolved prior to close of this fiscal year. Due to the current landlord's decision not to retain the previous management firm, billings have been sporadic and lacking in sufficient or required detail. Other state agencies, which also hold leases in the building, have had the same problem. All credits due will be applied to the balance payable.

RECOMMENDATION #6: *The Secretary of State should charge the statutory amount of 50 cents or consider having legislation introduced to the current session of the general assembly to amend the copying fees charged for public documents to the current practice.*

RESPONSE: Rejected.

I asked my staff to review the applicable Rhode Island General Laws and they have reported to me that while Title 42-8-20 (3) of Rhode Island General Laws (RIGL) requires the Corporations Division to charge 50 cents instead of the current 15 cents per copy page, the Access to Public Records Act (RIGL 38-2-4) stipulates a 15 cent per copy page fee. All documents at the Corporations Division are public records. Next legislative session, I will submit an amendment to the copy fee in Title 42 to make it consistent with the Access to Public Records Act. Until then, I will continue to charge the public 15 cents per copy page in order to keep our records accessible to people.

RECOMMENDATION #7: *Comply with RIGL 38-3-6.*

RESPONSE: Accepted.

During the first six months of my administration I asked all of my Directors to meet with the State Archivist and Public Records Administrator, R. Gwenn Stearn, to ensure that all Secretary of State Divisions complied with state law

regarding records control schedule. On February 28, 2003 a workshop by R.Gwenn Stearn was held for all Secretary of State Directors. Subsequently, a records control schedule for the Corporations Division has been prepared and submitted to the Public Records Administration.

RECOMMENDATION #8: *Consider utilizing a lock box to ensure that cash received is deposited in a timely manner in accordance with RIGL 11-28-1.*

RESPONSE: Partially Accepted.

Currently, the process of submission and acceptance of corporate annual reports is a cumbersome, paper-driven and labor-intensive process. My Office received 45,586 annual reports last year. Two weeks ago, I had 14 members of my staff working on a Saturday morning to help expedite the filing of for profit corporations annual reports and the deposit of the annual report fee. Even with this extra effort it is not feasible to file and deposit the fees in the time required by law. As part of my efforts to make it easier to start and run businesses I am committed to enabling the filing of corporate annual report on-line. We plan to start development of the online application in FY 2005. A lock box procedure would not be viable for this type of transaction. Furthermore, on-line filing will greatly reduce the number of paper reports and checks that will have to be handled and allow us to meet state law for deposit of payments. Quicker deposit of annual report filing fees will also allow for increased interest to be earned for the General Fund.

RECOMMENDATION #9: *The Secretary of State should consider having legislation introduced into the General Assembly to move the authority of assessing a 10 percent penalty of the franchise tax to a flat rate penalty to be assessed and collected by the Office of the Secretary of State.*

RESPONSE: Accepted.

A bill entitled "the revised Business Corporation Act" (H-7945 and S-2726) has been introduced this session that would, if passed, move the authority of assessing a 10% penalty fee of the franchise tax to a flat rate penalty of \$25.00 to be assessed and collected by the Office of the Secretary of State.

RECOMMENDATION #10: *Review assigned duties to ensure that work functions are properly segregated. Develop and implement policies and procedures to reconcile receipts and Non Sufficient check activity.*

RESPONSE: Accepted.

At my request, duties have been reviewed for all fiscal staff to ensure proper segregation. The procedure for Non Sufficient Funds check activity is being phased in with the POS implementation.

Thank you for the opportunity to include my response in your report. Please feel free to contact me or my Director of Administration, Nellie M. Gorbea if you have any questions regarding our response.

Sincerely,

A handwritten signature in black ink, appearing to read "Matt Brown", with a long horizontal flourish extending to the right.

Matt Brown
Secretary of State